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IN THE

Supreme Court of the United States

OCTOBER TERM, 1950.

No. 270

BLACKHAWK-PERRY CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT AND BRIEF IN SUPPORT OF PETITION.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT AND BRIEF IN SUPPORT OF PETITION.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petition of Blackhawk-Perry Corporation, respectfully prays for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit to review a judgment of that Court entered in this case on the 31st day of May, 1950.

I.

Summary and Short Statement of the Matter Involved.

This action involves the Petitioner's Income and Excess Profits tax liability for the calendar years 1942, 1943 and 1944. United States Court of Appeals for Eighth Circuit affirmed. Rec. 39. Decisions favorable to the Respondent

in the Tax Court of the United States and the Circuit Court of Appeals are set forth in the record (p. 22-p. 39). Facts in the case have been stipulated. The facts are extremely simple and so far as necessary to the statement of question herein involved are as follows:

Petitioner, a corporation organized under the laws of the State of Delaware and duly authorized to transact business in the State of Iowa, was organized for the purpose of taking title to property known as the Blackhawk Hotel and the Perry Apartments (both in the City of Davenport, Iowa), together with the furnishings and equipment therein contained, all of which had theretofore been mortgaged by Deed of Trust by Blackhawk Hotels Company to secure an outstanding bond issue of $1,497,500.00. Petitioner's organization and acquisition of the property was pursuant to a plan of reorganization proposed and confirmed in a proceeding under 77-B of the Bankruptcy Act. Under this plan Petitioner exchanged its capital stock for outstanding bonds of the transferor-debtor on a basis of one share of each $100 par value of bond and to the total amount of $1,497,500.00 of outstanding bonds. Petitioner commenced business August 1, 1935. Petitioner established as its basis for depreciation of that portion of the assets represented by the furnishings and equipment its cost, which was reached by scaling down the book values of the bankrupt proportionately to the amount of outstanding bonds and from which a cost of $215,267.67 was determined. This basis is not in dispute. Rec. page 20, Par. 6 of Stipulation.

Under the Commissioner's interpretation of the law and his regulations and rulings in force at the time Petitioner was required to use as its basis for depreciation its cost. The Commissioner had consistently ruled that an acquisition of property by bondholders of a transferor corporation was not within the exception of Sec. 112(g)(1)(D) I. R. C. and as such to require or permit Petitioner to use the sub-

stituted basis of its transferor. On February 2, 1942 this Court decided the cases of *Helvering* v. *Alabama Asphaltic Limestone Company,* 315 U. S. 179, 86 L. Ed. 775; *Palm Springs Holding Corporation* v. *Commissioner,* 315 U. S. 185, 86 L. Ed. 781; *Bondholders' Committee* v. *Commissioner,* 315 U. S. 189, 86 L. Ed. 784; *Helvering* v. *Southwest Consolidated Corporation,* 315 U. S. 195, 86 L. Ed. 789. The effect of these holdings was to reverse and overrule the Commissioner's previous interpretation of the law and application of his regulations and to hold that the transaction constituted a reorganization under Sec. 112(g)(1)(D) I. R. C. After a field examination in April, 1945, the Commissioner determined the adjusted basis of the transferor as of August 1, 1935 to be $66,625.56. Petitioner concedes the correctness of the determination of transferor's adjusted basis.

As a result of the action taken by the Commissioner in substituting, for the basis previously prescribed, the basis consistent with the holdings of the Court just referred to (or otherwise pursuant to Section 112(b)(10) I. R. C., Amendment of 1943), Petitioner suffered a diminution in its depreciable basis of $149,037.11. However that is not in issue here, Petitioner having acquiesced (in the conclusions of the holdings of those cases) so far as the substitution of basis was concerned. The Commissioner corrected the result ensuing from his misinterpretation of the law only to the extent of retroactively adjusting the basis by substitution of transferor's basis. The Commissioner refused to recompute the depreciation on the substituted basis, determined by the decisions just referred to to be correct as a matter of law, but insisted that under the rule announced in the *Virginian Hotel* case, 319 U. S. 523, 87 L. Ed. 1561, Petitioner's adjusted basis was to be reduced by the total amount of depreciation computed upon the basis erroneously prescribed by the Commissioner under the regulation referred to. The effect of this was to completely exhaust

Petitioner's adjusted depreciable basis in its loss years, and to deprive Petitioner of a deduction for depreciation for the years 1942, 1943 and 1944. If the law had been correctly and fully applied as contended for, Petitioner would have been entitled to a remaining depreciable basis of $38,124.65 as of December 31, 1941.

The result reached by the Commissioner in reliance upon the rule in the *Virginian Hotel* case was further reached by ignoring the applicability of the provisions of the Revenue Act of 1943, amendatory of Sec. 112 and Sec. 113 I. R. C., under which all proceedings under 77-B of the Bankruptcy Act involving the transfer of property pursuant to judicially authorized plan, were classified as reorganizations and specific provision was made for the use of transferor's basis in such cases and further provision was made that such amendment should be retroactively effective to January 1, 1933, but should in no event affect any tax liability prior to January 1, 1943, at which time the basis so prescribed became the basis upon which depreciation was thereafter to be computed.

II.

A statement particularly disclosing the basis upon which it is contended that the Supreme Court of the United States has jurisdiction to review the judgment of the United States Court of Appeals for the Eighth Circuit:

(a) The statutory provision believed to sustain the Jurisdiction of the Supreme Court of the United States. The Supreme Court of the United States has jurisdiction to review the judgment of the United States Court of Appeals by reason of the provisions of Section 1254 of Title 28 of the United States Code (Public Law 773—80th Congress, Chapter 646, 2d Session, 62 Stat. 928).

(b) The date of the judgment sought to be re-

viewed and the date upon which the petition for a writ of certiorari is presented:

(1) The date of the judgment sought to be reviewed is May 31, 1950.

(2) The date upon which the petition for a writ of certiorari is presented is August ....., 1950.

III.

The Questions Presented.

The questions presented are as follows:

(1) Where, through a mistake of law, the Commissioner has promulgated and applied an erroneous regulation to which the taxpayer conformed, can the Commissioner then correct his error of law to the extent such correction benefits the Treasury and at the same time refuse to accord the taxpayer the concomitant benefits of an initially correct application of the law?

(2) Can the Commissioner after prescribing the use of Petitioner's cost as its basis, by reason of his refusal to recognize its receipt of the property as a reorganization, retroactively substitute transferor's basis without at the same time recomputing theoretical depreciation upon such substituted basis and thereby establishing a new basis for the determination of tax liability from and after January 1, 1943?

(Sec. 112(b)10 I. R. C.; Sec. 113(a)(22) I. R. C.; Sec. 121(e) Revenue Act of 1943.)

THE REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

Petitioner believes that the decisions below have ignored the fundamental issue in this case and that the decisions establish a vicious principle in the administration of the tax law. In support of this statement it is pointed out the adverse decisions and the contention of the respondent are based upon an application of a rule announced in the case of *Virginian Hotel Corp.* v. *Helvering,* 319 U. S. 523, 87 L. Ed. 1561. Petitioner contends that assimilation of this case to that rule involves a complete misapplication of that rule and as well a complete evasion of the point urged by the Petitioner. In the *Virginian Hotel* case this Court "fashioned" a rule to cover a situation of frequent occurrence and attributable solely to a mistake of fact on the part of the taxpayer. This required a determination of the meaning of the word "allowed" in Sec. 113(b)(1)(B) I. R. C. under the circumstances of that case. The division of opinion on the part of the Court would indicate the question as what, under the circumstances, constituted "allowance" was by no means easy of solution. The case decides that a tax benefit is not a necessary element of allowance. It decides that where the taxpayer establishes a rate and claims a deduction for depreciation at that rate, it is "allowed" if not challenged by the Commissioner and the taxpayer may not retroactively correct his error by readjustment of his basis. It will be noted the decision rests upon two facts, erroneous action on the part of the taxpayer and inaction on the part of the Commissioner.

Petitioner now points out that in the instant case the regulation promulgated by the Commissioner; followed

in his rulings, decisions and treasury practice; and championed in extensive litigation erroneously required Petitioner to adopt as a basis for depreciation, not the adjusted basis of its transferor, but instead its cost. This for the reason that the commissioner by a literal reading of Sec. 112(g)(1)(D) I. R. C. concluded, as a matter of law that Petitioner was not amenable to the provisions of that section. Petitioner obviously had nothing whatsoever to do with the promulgation of the regulation or the interpretation of its legal consequences by the Commissioner. Petitioner's point is that where the Commissioner requires it to adopt a basis erroneous in law and where the law requires that it reduce that basis by setting up depreciation from year to year, it can not reasonably be said that such depreciation is "allowed" to it. Petitioner's contention is that such computation is required of it and if there be any error involved, it is an error attributable to the Commissioner's misinterpretation of the law in which, through mutual mistake, it concurred. If our analysis be correct, the point is novel and is not covered by the decision in the *Virginian Hotel* case.

Not only is the point novel, but the implications are far reaching and of transcending importance. So far as we have been able to find this Court has never passed on the consequences of a mistake of law on the part of the Commissioner in which the taxpayer has concurred by obedience to the regulation, nor has it defined the process by which the results of such error shall be undone, nor the limits of justice to be accorded or the limits of injustice to be approved by reason of administrative expediency or application of other pertinent provisions of law.

That the Court below ignored the fundamental implications of the problem is evident by the statement in its opinion that "the Government can not be estopped by a mistake made by a taxpayer" (R. 44). There is no ques-

tion of estoppel herein involved. Petitioner is not contending that the Commissioner was estopped to adjust the basis in conformity with the correct interpretation of the law. What Petitioner complains of is that the Commissioner retroactively corrected his mistake of law by adjusting the basis as of the date of its erroneous establishment through the Commissioner's own mistake and yet refused to fully correct the error, solely induced by the Commissioner's mistake of law, by recomputing the correct and allowable depreciation at the conceded proper rate. Implicit in the decision of the court below is the principle that the taxpayer will be penalized by concurring in the Commissioner's erroneous interpretation of law as expressed in his regulations to the extent that the correction of such error is beneficial to the Treasury, but can not have the benefit of a completely correct application of such principle of law to the extent that it will ameliorate the consequences of the Commissioner's error in respect to the law. Obviously this poses the question as to how far a taxpayer may rely upon the Commissioner's interpretation of the law in computing his tax return.

It is submitted that it is a vicious doctrine, both by reason of administrative consequences, as well as by repugnance to any sense of justice, that the Treasury can profit by its error, but that the taxpayer must bear the full burden of its initial acquiescence in such error of law. It is submitted that taxpayers generally are entitled to know by authoritative pronouncement from this Court how far they are entitled, with some degree of safety to themselves, to rely upon the Commissioner's regulations and the Treasury practice and interpretation of such regulations, in so far as such questions must be answered by the Treasury, or otherwise by resort to the courts.

In its opinion (Rec. p. 44) the Court below says Petitioner is mistaken as to the meaning and application of the

law prior to the decisions of the Supreme Court in *Helvering* v. *Alabama Asphaltic Limestone Company*, 315 U. S. 179, 86 L. Ed. 775, etc. It is our contention that this illustrates the fact that the court below viewed this situation through the wrong end of the telescope. The mistake as to the meaning and application of the law was the Commissioner's, as indicated by his regulation, interpretations and his prolific litigation in support of his contention as advanced in *Helvering* v. *Alabama Asphaltic Limestone Company* (315 U. S. 179, 86 L. Ed. 775) and companion cases. The mistake, if any, of the Petitioner was in accepting the Commissioner's Regulation as its guide as to the meaning of the law.

Petitioner, therefore, respectfully urges that the time has come when taxpayers generally are entitled to know the consequences of reliance upon regulations of the Commissioner in respect to compulsory deductions, be they of depreciation or of other deductible items and more especially in respect to deductions for depreciation where made under a formula, one of the controlling factors of which is prescribed as a matter of law.

Finally Petitioner contends that the procedure employed, in determining and assessing the deficiencies, directly contravenes the provisions of Sec. 112(b)(10) and Sec. 113(a)(22) I. R. C. and the further provisions of Sec. 121(e) of the Revenue Act of 1943. These amendments were specifically stated in the Committee Reports to be intended to establish the rule for determining the basis of corporations organized under 77-B of the Bankruptcy Act. While retroactive for purposes of computation, the time for application of the new basis in determining tax liability was January 1, 1943. Respondent has misapplied the law as amended.

Wherefore, your petitioner respectfully prays that a Writ of Certiorari be issued out of and under the seal of

this honorable Court directed to the United States Court of Appeals for the Eighth Circuit, commanding that court to certify and send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in this cause to the end that the said cause may be reviewed and determined by this Court according to law; and that your Petitioner may have such other and further relief as to this Court may seem proper and in conformity with law.

And your Petitioner will ever pray.

WAYNE G. COOK,
CARL H. LAMBACH,
Attorneys for Petitioner.

Dated: August 23, 1950.

PETITIONER'S BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

OPINIONS OF THE COURTS BELOW.

The opinion of the United States Court of Appeals for the Eighth Circuit is reported in 182 Fed. (2d) 319 (see pp. 39-44 of the Record). The opinion of The Tax Court of the United States is in a memorandum opinion, Dec. 16, 706 (M) (see pp. 22-26 of the Record).

JURISDICTION.

The grounds on which the jurisdiction of the Supreme Court of the United States is invoked are set forth beginning at page 4 herein, in the Petition for Writ of Certiorari.

STATEMENT OF THE CASE.

The facts are as set forth, beginning at page 4 herein, in the Petition for Writ of Certiorari.

SPECIFICATION OF ERRORS.

1. The United States Court of Appeals for the Eighth Circuit erred in determining that the deficiencies in Petitioner's Income and Declared Value Excess Profits Tax for the years 1942 and 1943.

2. The United States Court of Appeals for the Eighth Circuit erred in determining that the deficiencies in Petitioner's Income and Declared Value Excess Profits Tax for the year 1944.

3. The United States Court of Appeals for the Eighth Circuit erred in holding the rule of *Virginian Hotel Corp.* v. *Helvering,* 319 U. S. 523, 87 L. Ed. 1561, applicable to a situation where the Treasury is seeking to correct its error of law.

4. The United States Court of Appeals for the Eighth Circuit erred in holding and deciding that Respondent retroactively properly adjusted Petitioner's basis, theretofore established in conformity with Respondent's regulation and interpretation of the applicable law, without concomitantly correcting the entire error by recomputing and readjusting depreciation on the substituted basis.

SUMMARY OF THE ARGUMENT.

A mistake of law promulgated by Regulation and followed in Treasury practice when followed by taxpayer does not bring taxpayer within the rule of *Virginian Hotel Corp.* v. *Helvering,* 319 U. S. 523, 87 L. Ed. 1561. If the Commissioner seeks retroactively to correct such error, the entire result should be corrected and not that part alone which benefits the Treasury. A deduction for depreciation computed upon a basis erroneously required to be used by the taxpayer is not "allowed" within the rule of the *Virginian* case. Apart from unsoundness in principle, the procedure of Respondent complained of ignores or contravenes the provisions of the amendments to Sections 112 and 113 of the Internal Revenue Code by Section 121 of the Revenue Act of 1943 and particularly of Section 121 (e).

BRIEF POINTS AND AUTHORITIES.

I.

Unless within a statutory exception, taxpayer's basis is taxpayer's cost.

Section 113 (a) Internal Revenue Code.
Section 113 (b) Internal Revenue Code.
Section 113 (b)(1)(B) Internal Revenue Code.
Section 114 (a) Internal Revenue Code.

II.

The Commissioner had consistently refused by Regulation and practice to recognize the succession of bondholders of an insolvent debtor to its property as a reorganization within Section 112 of the Internal Revenue Code.

Pinellas Ice and Cold Storage Company v. *Commissioner,* 287 U. S. 462, 77 L. Ed. 429.

LeTulle v. *Scofield,* 308 U. S. 413, 84 L. Ed. 355.

Helvering v. *New Haven and S. L. R. Co.,* 121 Fed. (2d) 985 (C. C. A. 2).

Commissioner of Internal Revenue v. *Tyng,* 106 Fed. (2d) 55 (C. C. A. 2).

Commissioner of Internal Revenue v. *Bondholders Committee,* 118 Fed. (2d) 511 (C. C. A. 9).

Helvering v. *Alabama Asphaltic Limestone Company,* 315 U. S. 179, 86 L. Ed. 775.

Palm Springs Holding Corporation v. *Commissioner of Internal Revenue,* 315 U. S. 185, 86 L. Ed. 780.

Bondholders Committee v. *Commissioner of Internal Revenue,* 315 U. S. 189, 86 L. Ed. 784.

Helvering v. *Southwest Consolidated Corporation*, 315 U. S. 194, 86 L. Ed. 789.

Warwick Hotel v. *U. S.*, 69 Fed. Sup. 242, affirmed 158 Fed. (2d) 961.

C. C. H. 1938, Federal Tax Service, p. 8033, Sec. 6044, Commissioner's letter to Colorado Fuel & Iron Corporation.

III.

Where taxpayer follows a treasury practice, erroneous as a matter of law, and uses a basis conformable to the requirements of the Commissioner, the rule "fashioned by the Court" in *Virginian Hotel Corporation* v. *Helvering*, 319 U. S. 523, 87 L. Ed. 1561, is not applicable, nor is the resultant required computation, depreciation "allowed", within such rule or within a reasonable interpretation of the word "allowed" under such circumstances.

IV.

Procedural compliance with Section 121 of the Revenue Act of 1943, amending Sections 112 and 113, I. R. C., will sustain Petitioner's claim and obviate any need for application of the rule in the *Virginian Hotel* case.

Revenue Act of 1943, c. 63, 58 Stat. 21, Sec. 121 (26 U. S. C., 1946 ed., Secs. 112, 113).

Conference Committee Report on the Revenue Bill of 1943, No. 1079, 78th Congress, 2d Session.

Senate Finance Committee Report on the Revenue Bill of 1943, 78th Congress.

ARGUMENT.

The situation presented in this case is one where the taxpayer has followed a regulation promulgated by the Commissioner, which regulation it later turns out, by reason of subsequent holdings of this Court, was totally erroneous in both its legal concept and its application. As we point out the cost to taxpayer is the usual basis for the computation of gain or loss and depreciation. Certain exceptions are made in the Code and if within these exceptions the taxpayer is permitted or required, as the case may be, to use a different basis. Congress by legislative action excepts from the general rule reorganizations (Sec. 112, I. R. C.) and details at length variant situations arising in connection with corporate reorganizations.

Our case has a special reference to Sec. 112(g)(1)(D), I. R. C. The effect of the application of that section in the great majority of instances was to give the transferee of property from a predecessor debtor corporation the benefit of inclusion of the debtor's equity value in the transferee's basis, which it could subsequently depreciate and thereby secure a larger deduction. It would also have an enlarged basis for computation of loss or gain with corresponding benefits accruing from the establishment of the higher basis. The Commissioner could not have been unmindful of the fact that a liberal interpretation of the section would produce a corresponding diminution in revenue. Resultantly the Commissioner adopted a policy of narrow interpretation and of strict requirement of literal compliance of each provision of the law.

This attitude of the Commissioner is evidenced by his regulation on the subject (Regulation 86, Sec. 112(g)(1) Rev. Act of 1934 set forth in Appendix). It is confirmed

by his numerous rulings, one of which we set forth by way of example in the Appendix (p. 26). It is conclusively established by his dogged resistance in the various cases litigated both in the courts below and in those which finally reached this Court, and which we have cited under Point II of the accompanying brief. The case of *Warwick Hotel* v. *U. S.*, 69 Fed. Sup. 242, and affirmed 158 Fed. (2d) 961, is cited to show that as late as 1946 the Commissioner was still pursuing his policy of narrow interpretation of the provisions of Sec. 112(g)(1). Until the decision of this Court in the case of *Helvering* v. *Alabama Asphaltic Limestone Co.*, 315 U. S. 179, 86 L. Ed. 775, and the three companion cases decided at the same Term the Commissioner had very definitely and quite uniformly refused to recognize a continuity of interest in situations where bondholders had acquired the property of a predecessor debtor corporation. The Commissioner's position was that bondholders were not "shareholders" and the literal requirement of the law was such that, to qualify as a reorganization, the transferor or its stockholders had to end up in control of the property transferred. This will be fully established by a reference to the briefs of the Government filed in the *Alabama Asphaltic Limestone* case and by reference to the opinions in the other cases cited under Brief Point II. We do not understand that respondent will seriously dispute this fact. These subsequent decisions, of course, constituted a reversal of the Commissioner on his point of law and established that Petitioner was within the exception.

It is urged that Petitioner was mistaken in this matter. It is submitted that the Petitioner was not the one who was mistaken, but the Treasury expressing itself through the Commissioner. Diligent search on our part has failed to produce any precedent which we can cite in aiding this Court to now "fashion" a rule which will cover this situation. The situation is one either of unilateral mistake on

the part of the Commissioner or if not, then a mutual mistake of law on the part of the Commissioner and the taxpayer. It seems needless to point out that the gross inequity in permitting the Commissioner to retroactively correct his mistake of law by substituting a lower basis, upon which depreciation would otherwise have been computed, and at the same time binding the taxpayer to the consequences of taxpayer's previous computation of depreciation upon a basis erroneously prescribed by the Commissioner, is sufficient to justify a full examination of such procedure before it shall receive the stamp of judicial approval.

Respondent seeks to justify, what to us under the circumstances seems utterly unconscionable, by reliance upon the holding in the case *Virginian Hotel Corp.* v. *Helvering*, 319 U. S. 523, 87 L. Ed. 1561. In fact up to this point the holding in that case appears to be the only justification offered for what otherwise admittedly seems to be a grossly inequitable determination of tax liability.

It, therefore, becomes necessary to determine whether the rule "fashioned" by the Court in the *Virginian Hotel* case is controlling under the circumstances here presented. Certain obvious, as well as fundamental, distinctions appear to us to put this case entirely beyond the scope of any holding in the *Virginian Hotel* case. We have elaborated this point in our statement of reasons why this Court should now grant the Writ prayed for. Without repeating those reasons it is our contention that no one of the reasons assigned by the Court for "fashioning the rule" announced in the *Virginian Hotel* case can be assigned as a similar reason for its application in this case. The rule in the *Virginian Hotel* case was predicated upon the assumption that in the absence of such rule the taxpayer might secure a double benefit. If the rule be limited to a mistake that taxpayer may have made, no exception

need be taken to it. What we are here concerned with is not something which the taxpayer has done, but with an interpretation of law given out by the Commissioner to whom the taxpayer not only has the right to look for such interpretation of law, but to whom generally speaking the orderly administration of the Internal Revenue Code would require him to look as a matter of legal duty. It is not to be presumed that the Commissioner will make any errors that will permit the taxpayer any double deduction. Nor does taxpayer in the present instance seek to capitalize upon the Commissioner's error and thereby secure a double deduction. What is complained of is that the Commissioner having erroneously held in his regulation and in Treasury practice that Petitioner was required to use its cost, the Treasury should not be allowed to benefit from such error of law by being permitted to retroactively substitute a lower depreciable basis and at the same time refuse to recompute the depreciation upon the substituted basis. The effect of this is to permit the Commissioner to do exactly what the taxpayer was denied the privilege of doing in the *Virginian Hotel* case.

In the *Virginian Hotel* case, however, the mistake was one of fact and in this case the mistake is one of law on the part of the Commissioner. It is our thought that the Court must now "fashion" a rule defining the procedure in situations of this type. It is our further thought that the transaction should be treated as a nullity from its inception. In such view of the matter the basis required to be used would be discarded as one required in violation of law. The Commissioner would proceed to substitute the proper legal basis and the computation would be made ignoring the consequences of the Commissioner's prior erroneous action. This does not then involve any question as to the application of an administrative text as to when depreciation is allowed for purposes of determining how

far taxpayer may go in correcting his error. It simply recognizes what is the fact that no depreciation is said to be allowed, which is the resultant of two factors, one of which the Commissioner erroneously has required to be used.

For purposes of the consideration of this petition we believe we have extended this argument sufficiently to indicate quite fully what is otherwise a simple question. It will be recognized that the granting or denial of this Writ will not concern itself so much with the immediate consequences to the Petitioner as with the larger question of administrative practice. The result of the decision of the Circuit Court, if sustained by this Court, will mean that no taxpayer can with safety to himself follow the regulations of the Commissioner and the Treasury practice consistent therewith. This decision, if it be permitted to stand, justifies the conclusion that in so far as the correction of an error of law on the part of the Commissioner will benefit the Treasury such correction can be made, but that the Treasury is under no corresponding duty to apply that same correct principle of law in reaching what, in time at least, would have been a result wholly consistent with the law.

We have argued this matter upon the ground of the principle involved in the procedure of the Commissioner, ignoring for the time the effect of the amendment to Sections 112 and 113 by Sec. 121 of the Revenue Act of 1943. The Act was extended in terms to cover proceedings under Sec. 77-B of the Bankruptcy Act. The Committee reports clearly indicate the amendment was adopted for the purpose of setting at rest the troublesome questions which confronted parties affecting reorganizations and which were generated by the attitude of the Commissioner in narrowly and technically interpreting the provisions of Sec. 112 as we have pointed out. At the same time in

Sec. 121 (c) (3) of the same Act specific provision was made for substitution of the basis of the transferor. Finally in Sec. 121 (e) of the Act it was provided that the amendments were made effective for taxable years beginning after December 31, 1933, but not affecting any tax liability for any taxable year beginning prior to January 1, 1943.

The Committee report indicates a purpose to make any reorganization under 77-B one for non-recognition of loss or gain, and to eliminate the confusion as to the basis because of many critical distinctions theretofore made and the corresponding divergence of judicial holdings in respect thereto. The report, however, significantly includes another declaration of intent in respect to determining tax liability of such corporations. We quote an excerpt from the Conference Committee's report on the Revenue Bill of 1943:—

> "For reason of administration, however, it is provided that such amendments shall not operate to affect the tax liability for any taxable year beginning prior to January 1, 1940 (1943). Thus, for example, in the case of a corporation emerging from reorganization in 1936, although the amendments with respect to basis will have an indirect effect in that depreciation of assets for the taxable year 1940 (1943) and subsequent years will be computed as if the assets had been carried and depreciated at the transferor's basis throughout the intervening years, 1940 (1943) will be the first year under this amendment in which the transferor's basis, adjusted for theoretical depreciation sustained in intervening years, would properly constitute the basis for depreciation to the reorganized corporation to which this amendment applies."
>
> (The year 1943 is set forth in parentheses in the Section quoted by reason of a change making the Bill effective as of January 1, 1943 indicated in the same Conference Committee's Report.)

It will be noted from the foregoing report Congress had in mind a procedure identical with that which we contend

for here. In our view of the matter the amendment of 1943 precluded adjustments affecting tax liability prior to its effective date of January 1, 1943, and required that the Commissioner redetermine the basis for the computation of future tax liability by computing the theoretical depreciation upon the theoretical basis from August 1, 1935. Application of the amendment of 1943, if given the effect intended for it by the Conference Committee's Report, would entirely eliminate any application of the rule in the *Virginian Hotel* case.

Finally it is our belief that the amendment of the Revenue Act of 1943 precludes a readjustment of tax liability for the year 1942 and requires a recomputation and readjusted basis commencing with the year of January 1, 1943.

Conclusion.

We, therefore, earnestly contend that the Writ of Certiorari should be granted as herein prayed for.

Respectfully submitted,

WAYNE G. COOK,
CARL H. LAMBACH,
Attorneys for Petitioner.

APPENDIX.

Internal Revenue Code:

Sec. 23 (as amended by Sec. 121 (c), Revenue Act of 1942, c. 619, 56 Stat. 798). Deductions From Gross Income.

In computing net income there shall be allowed as deductions:

* * * * *

(1) Depreciation.—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

* * *

* * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

Sec. 113. Adjusted Basis for Determining Gain or Loss.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

* * * * *

(b) Adjusted Basis.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) General rule.—Proper adjustment in respect of the property shall in all cases be made—

* * * * *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this chapter or prior income tax laws.

* * * * *

(26 U. S. C. 1946 ed., Sec. 113.)

Sec. 114. Basis for Depreciation and Depletion.

(a) Basis for Depreciation.—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of

determining the gain upon the sale or other disposition of such property.

* * * * *

(26 U. S. C. 1946 ed., Sec. 114.)

Sec. 112. Recognition of Gain or Loss.

* * * * *

(g) Definition of Reorganization.—As used in this section (other than subsection (b) (10) and subsection (1)) and in section 113 (other than subsection (a) (22)).—

(1) The term "reorganization" means * * *

(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred * * *. (26 U. S. C. 1946 ed., Sec. 112.)

Revenue Act of 1943, c. 63, 58 Stat. 21:

Sec. 121. Reorganization of Certain Insolvent Corporations.

(a) Nonrecognition of Gain or Loss on Certain Reorganizations.—Section 112(b) (relating to recognition of gain or loss upon certain exchanges) is amended by inserting at the end thereof the following:

"(10) Gain or loss not recognized on reorganization of corporations in certain receivership and bankruptcy proceedings.—No gain or loss shall be recognized if property of a corporation (other than a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended) is transferred, in a taxable year of such corporation beginning after December 31, 1933, in pursuance of an order of the court having jurisdiction of such corporation—

"(A) in a receivership, foreclosure, or similar proceeding, or

"(B) in a proceeding under section 77B or Chapter X of the National Bankruptcy Act, as amended,

to another corporation organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, in exchange solely for stock or securities in such other corporation."

* * * * *

(c) Basis.—Section 113 (a) (relating to basis of property) is amended—

* * * * *

(3) by inserting after paragraph (21) the following:

"(22) Property acquired on reorganization of certain corporations.—If the property was acquired by a corporation upon a transfer to which section 112(b)(10), or so much of section 112(d) or (e) as relates to section 112(b)(10), is applicable, then, notwithstanding the provisions of section 270 of the National Bankruptcy Act, as amended, the basis in the hands of the acquiring corporation shall be the same as it would be in the hands of the corporation whose property was so acquired, increased in the amount of gain recognized to the corporation whose property was so acquired under the law applicable to the year in which the acquisition occurred, and such basis shall not be adjusted under subsection (b) (3) by reason of a discharge of indebtedness pursuant to the plan of reorganization under which such transfer was made."

* * * * *

(e) Effective Date.—Provisions having the effect of the amendments made by subsection (a), subsection (c)(3), and subsection (d)(2), (3), (4), (5), and (6), shall be deemed to be included in the revenue laws respectively applicable to taxable years beginning after December 31, 1933, but shall not affect any tax liability for any taxable year beginning prior to January 1, 1943. Provisions having the effect of the amendments made by subsection (b), subsection (c)(1) and (2), and subsection (d)(1), shall be deemed to be included in the revenue laws respectively applicable to taxable years beginning after December 31, 1931.

(26 U. S. C. 1946 ed., Secs. 112, 113.)

Treasury Regulation 86, Sec. 112 (g) (1) Revenue Act of 1934:

Art. 112 (g) (1)—Purpose and scope of exception of reorganization exchanges.—Purpose: Under the general rule, upon the exchange of property, gain or loss

must be accounted for if the new property differs in a material particular, either in kind or in extent, from the old property. The purpose of the reorganization provisions of the Act is to except from the general rule certain specifically described exchanges incident to such readjustments of corporate structures, made in one of the particular ways specified in the Act, as are required by business exigencies, and which effect only a readjustment of continuing interests in property under modified corporate forms. Requisite to a reorganization under the Act are a continuity of the business enterprise under the modified corporate form, and a continuity of interest therein on the part of those persons who were the owners of the enterprise prior to the reorganization. * * *''

* * * * *

Commissioner's letter to Colorado Fuel & Iron Corporation, C. C. H. 1938, Federal Tax Service, p. 8033, Sec. 6044:

''Reorganization is defined by section 112 (g)(1) as follows:

''The term 'reorganization' means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock; of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form or place of organization, however, effected.

''It does not appear that any attempt was made to effect a merger or consolidation in pursuance of the corporation laws of the United States or of a state or territory of the District of Columbia, so as to constitute a reorganization within the meaning of section 112 (g)(1)(A) of the Act and article 112 (g)-2 of Regulations 94. The fact that the transaction was consum-

mated pursuant to the provisions of section 77B of the Amended Bankruptcy Act does not, in the opinion of this office, make it a statutory merger or consolidation within the meaning of the Act. The transaction does not qualify as a reorganization under (B) or (C) since the new corporation did not acquire the properties solely in exchange for all or a part of its voting stock, and the transferor or its stockholders or both were not in control of the new corporation immediately after the transfer. A recapitalization involves a corporate readjustment of existing interests and the rearrangement of the capital structure. It is the view of this office that the transfer of all or a part of the assets of a corporation to a new corporation cannot be considered a recapitalization within the meaning of (D). It is also clear that the transaction involved more than a mere change in identity, form or place of organization, as contemplated under (E).

"It is therefore, the opinion of this office, that the exchanges of the securities of the Colorado Fuel and Iron Company and the Colorado Industrial Company for securities of the Colorado Fuel and Iron Corporation were not made in connection with a reorganization as defined by section 112 (g)(1) of the 1936 Act. Under the provisions of section 112 (a) the gains or losses resulting from such exchanges will accordingly be recognized for income tax purposes, subject to the limitations prescribed by section 117. In view of the restrictions contained in the court order of June 20, 1936, the amounts of such gains or losses should be determined on the basis of the fair market values of the securities (including warrants) of the new corporation on September 1, 1936, the date the new securities were first available for distribution.

"In accordance with the provisions of section 113 (a) and section 114 of the Revenue Act of 1936, the basis for depletion or depreciation and gain or loss on the subsequent sale or other disposition of the assets acquired on July 1, 1936, will be the cost of such assets since none of the exceptions enumerated under section 113 is applicable."

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In the Supreme Court of the United States

OCTOBER TERM, 1950

No. 270

BLACKHAWK-PERRY CORPORATION, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

---

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 22-28) are not reported. The opinion of the Court of Appeals (R. 39-44) is reported at 182 F. 2d 319.

JURISDICTION

The judgment of the Court of Appeals was entered May 31, 1950. (R. 45.) The petition for a writ of certiorari was filed August 25, 1950. The

jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the taxpayer is required by Section 113(b)(1)(B) of the Internal Revenue Code to adjust its depreciation basis in the taxable years by deducting amounts of prior depreciation allowances claimed in tax returns for earlier years which were accepted by the Commissioner.

STATUTES INVOLVED

The statutes involved are set forth in the Appendix, *infra*, pp. 9-13.

STATEMENT

The facts with respect to the only issue here involved were stipulated (R. 18-21), and were found by the Tax Court (R. 22-24) as follows:

The taxpayer is a corporation organized under the laws of Delaware and doing business in Iowa. It was incorporated for the purpose of taking title to properties known as the Blackhawk Hotel and the Perry Apartments, both located in Davenport, Iowa, together with furnishings and equipment previously mortgaged by deed of trust by Blackhawk Hotels Company to secure an outstanding bond issue of $1,497,500. At the time there were pending proceedings under Section 77B of the Bankruptcy Act, and a plan of reorganization was approved by the court under which title to the

Blackhawk Hotel and the Perry Apartments, together with the contents thereof, were conveyed by the debtor Blackhawk Hotels Company to the taxpayer Blackhawk-Perry Corporation. The property so conveyed comprised the major part of the security conveyed by the deed of trust. The property covered by the deed of trust, but not conveyed to the taxpayer, consisted of several leasehold estates on hotel properties, together with their equipment. This property was transferred to the lessors in pursuance of landlords' liens. (R. 22-23.)

Under the plan of reorganization each holder of outstanding bonds of Blackhawk Hotels Company was entitled to receive, upon surrender of his bonds, shares of the capital stock of the taxpayer at the rate of one share of stock for each $100 principal amount of bonds. (R. 23.) The taxpayer requested of the debtor corporation a statement of the net book value of the equipment and furnishings of the various properties. The net book values so furnished were scaled to the actual amount of the bonds theretofore issued and outstanding, i.e., $1,497,500. (R. 23.)

The basis to the taxpayer established pursuant to the closing entries furnished by the comptroller of transferor, Blackhawk Hotels Company, for furnishings and equipment, was $215,672.67. The taxpayer ascribed to the personal property a useful life of 15 years and set forth such a rate on its return. From August 1, 1935, to and including December 31, 1944, the taxpayer computed its de-

preciation at the rate of $14,378.18 per annum (R. 23-24).

This was an erroneous basis. (R. 24.) The Commissioner, in computing the basis for depreciation, correctly adjusted the basis of the taxpayer to the basis in the hands of the transferor, Blackhawk Hotels Company, and thus established a basis of $66,625.56 for the personal property. (R. 24.)

After examination of the taxpayer's books and tax reports, deficiencies were asserted by the Commissioner in the amount of $8,627.89 for the year 1942, $11,630.92 for the year 1943, and $9,038.45 for the year 1944. The deficiencies resulted in part for the years 1942 and 1943, and entirely for the year 1944, from adjustments made by the Commissioner in the disallowance of depreciation on the personal property referred to above. (R. 24.)

As against the adjusted basis of $66,625.56 the Commissioner charged the amount of depreciation deducted by the taxpayer in its returns for the years following August 1935. As a consequence the Commissioner disallowed further depreciation for the years 1942 to 1944, inclusive, the period involved herein with resultant increase in the taxpayer's tax liability. No tax benefit accrued in any year to the taxpayer and its returns were accepted as filed by the Commissioner for the years barred by the statute of limitations. (R. 24.)

The Tax Court sustained the Commissioner's determination in respect of the issue thus presented

(R. 25-26), and the Court of Appeals affirmed the Tax Court's decision (R. 44).

ARGUMENT

Both the Tax Court (R. 25-26) and the Court of Appeals (R. 44) correctly held that this case was governed by *Virginian Hotel Co.* v. *Helvering,* 319 U.S. 523, rehearing denied, 320 U.S. 810. The taxpayer's only contention (Pet. 7-8) is that the latter case is inapplicable because the Commissioner is estopped to invoke its principles here. To be sure, the taxpayer (Pet. 8) disavows any intention to claim such estoppel; but that is what its contention amounts to in essence, and so the Court of Appeals regarded it, holding it to be without merit (R. 44). We submit its decision in this respect is not only correct, but in the absence of a conflict presents no justification for further review. The case turns upon its own particular facts and involves no questions of law having general importance.

The taxpayer acquired the property in question in a Section 77B proceeding. In view of the holdings in *Helvering* v. *Limestone Co.,* 315 U.S. 179, and *Palm Springs Corp.* v. *Commissioner,* 315 U.S. 185, it was stipulated that the correct basis for depreciation of the property in the hands of the taxpayer was the same as the adjusted basis in the hands of its transferor, namely, $66,625.56. The stipulation therefore removed from the case any question as to the proper basis for the computation of depreciation allowances to which the taxpayer

was entitled under Section 114(a) of the Internal Revenue Code, Appendix, *infra,* p. 10.

However, instead of computing its deductions for depreciation on such basis, the taxpayer computed them on the basis of its own cost of the property, namely, $215,672.67. Thus the aggregate of the deductions which it claimed in years prior to the taxable years here in question, which were accepted by the Commissioner as claimed (R. 21), exceeded its statutory basis, though without tax benefit (R. 20-21).

Section 114(a) provides, among other things, that the basis upon which exhaustion, wear and tear shall be allowed in respect of any property shall be adjusted as provided in Section 113(b). Thus the only question which the stipulation left in controversy was with respect to the adjustments properly to be made to such basis under Section 113(b)(1)(B), Appendix, *infra,* pp. 9-10. This section requires that proper adjustment shall be made for periods prior to the taxable years for exhaustion, wear and tear of the property to the extent allowed; and under the interpretation placed upon that section in the *Virginian Hotel Co.* case, *supra,* such amount is that claimed by the taxpayer and not challenged by the Commissioner, including any part thereof for which the taxpayer, as here, may have received no tax benefit.

The taxpayer's contention here (Pet. 6-7) is that, in accordance with erroneous Regulations

current in years prior to the decisions of this Court in the *Limestone Co.* and *Palm Springs Corp.* cases, *supra,* the Commissioner required it to adopt its cost as its basis and not its transferor's adjusted basis; hence, it argues (Pet. 8), the Commissioner may not correct the situation in part by retroactively adjusting the taxpayer's basis to the correct amount and denying it the concomitant benefit of revising the depreciation to be computed thereon.

But such contention is tantamount to saying that the alleged action of the Commissioner in originally requiring the taxpayer by erroneous Regulations to take its own cost as a basis for depreciation, instead of its transferor's adjusted basis, renders the provisions of Section 113(b)(1)(B) as construed by this Court inapplicable; in other words, that such action estops the Commissioner from enforcing the section against it. There is no basis for such estoppel in the present case. There is no evidence in the record that the Commissioner, in effect, or at all, required the taxpayer to compute its depreciation allowance upon an erroneous basis. There is nothing to show that the Commissioner's attention was at any time prior to his consideration of the taxpayer's returns for the taxable years here in question specifically directed to the error which the taxpayer had made in computing its basis for depreciation. On the contrary, upon the record here, it would be as consistent to conclude that the taxpayer's erroneous use of its cost as the basis was dictated by the fact

that such cost was larger than its transferor's basis, as it would be to conclude that its action was motivated by the necessity of complying with the Regulations. During all the period in question other taxpayers were attacking the Regulations when it was to their advantage to do so, and such attack, of course, ultimately proved successful in the *Limestone Co.* and *Palm Springs Corp.* cases, *supra.*

CONCLUSION

The decision of the court below rests on the particular facts of the case, is plainly correct, and presents no conflict. The petition for a writ of certiorari should be denied.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

THERON LAMAR CAUDLE,
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CARLTON FOX,
Special Assistants to the Attorney General.

SEPTEMBER, 1950

APPENDIX

Internal Revenue Code:

SEC. 23 [As amended by Sec. 121(c), Revenue Act of 1942, c. 619, 56 Stat. 798]. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(l) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or * * *.

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

* * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General rule.*—Proper adjustment in respect of the property shall in all cases be made—

* * * * *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this chapter or prior income tax laws.

* * * * *

(26 U.S.C. 1946 ed., Sec. 113.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property.

* * * * *

(26 U.S.C. 1946 ed., Sec. 114.)

Revenue Act of 1943, c. 63, 58 Stat. 21:

SEC. 121. REORGANIZATION OF CERTAIN INSOLVENT CORPORATIONS.

(a) *Nonrecognition of Gain or Loss on Certain Reorganizations.*—Section 112(b) (relating to recognition of gain or loss upon certain exchanges) is amended by inserting at the end thereof the following:

"(10) *Gain or loss not recognized on reorganization of corporations in certain receivership and bankruptcy proceedings.*—No gain or loss shall be recognized if property of a corporation (other than a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended) is transferred, in a taxable year of such corporation beginning after December 31, 1933, in pursuance of an order of the court having jurisdiction of such corporation—

"(A) in a receivership, foreclosure, or similar proceeding, or

"(B) in a proceeding under section 77B or Chapter X of the National Bankruptcy Act, as amended,

to another corporation organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, in exchange solely for stock or securities in such other corporation."

* * * * *

(c) *Basis.*—Section 113(a) (relating to basis of property) is amended—

* * * * *

(3) by inserting after paragraph (21) the following:

"(22) *Property acquired on reorganization of certain corporations.*—If the prop-

erty was acquired by a corporation upon a transfer to which section 112(b)(10), or so much of section 112(d) or (e) as relates to section 112(b)(10), is applicable, then, notwithstanding the provisions of section 270 of the National Bankruptcy Act, as amended, the basis in the hands of the acquiring corporation shall be the same as it would be in the hands of the corporation whose property was so acquired, increased in the amount of gain recognized to the corporation whose property was so acquired under the law applicable to the year in which the acquisition occurred, and such basis shall not be adjusted under subsection (b)(3) by reason of a discharge of indebtedness pursuant to the plan of reorganization under which such transfer was made."

* * * * *

(e) *Effective Date.*—Provisions having the effect of the amendments made by subsection (a), subsection (c)(3), and subsection (d)(2), (3), (4), (5), and (6), shall be deemed to be included in the revenue laws respectively applicable to taxable years beginning after December 31, 1933, but shall not affect any tax liability for any taxable year beginning prior to January 1, 1943. Provisions having the effect of the amendments made by subsection (b), subsection (c)(1) and (2), and subsection (d)(1), shall be deemed

to be included in the revenue laws respectively applicable to taxable years beginning after December 31, 1931.

(26 U.S.C. 1946 ed., Secs. 112, 113.)

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1950

No. 270

BLACKHAWK-PERRY CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

SUPPLEMENTAL BRIEF FOR PETITIONER

CARL H. LAMBACH,
W. A. SUTHERLAND,
Counsel for Petitioner.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1950

No. 270

BLACKHAWK-PERRY CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

SUPPLEMENTAL BRIEF FOR PETITIONER

The petition and the brief in support thereof point out the distinction between this case and the *Virginian Hotel* case and advance that distinction as a reason why the Court should not consider itself bound by the *Virginian Hotel* rule. Even if the Court should conclude that no such distinction exists, however, it should assuredly take this opportunity to overrule *Virginian Hotel,* the unfairness and unreasonableness of which are here highlighted as never before in actual litigation by the simple facts of this case.

Reduced to its essence, the present case presents the following picture: The taxpayer in 1935, relying upon an invalid Treasury Regulation, attributed to its property then acquired an erroneously high basis. There is no question but that this basis was wrong as a matter of law from the

very beginning, in the light of facts then known. Thereafter the taxpayer applied the correct rate of depreciation to its erroneously high basis and entered the resulting figures on its tax returns. The error resulted in no tax benefit during the years 1935 through 1941 since the taxpayer would have had a net loss for each of those years even if only the correct depreciation deduction had been shown. The Commissioner accepted the taxpayer's returns without question during those years, but asserted deficiencies against the taxpayer for the years 1942, 1943 and 1944—the first profit years—basing his determination on the disallowance of depreciation deductions for those years.

He first established the correct basis of the property at the time of acquisition in 1935, thus correcting the taxpayer's original error, and then concluded that that correct basis should be reduced by the erroneously high depreciation figures which the taxpayer had entered on its books and tax returns in the intervening years, although the error in those figures resulted solely from the use by the taxpayer of the incorrect original basis. The result was that in the taxable years in question the Commissioner concluded that the taxpayer had no adjusted basis left against which he might apply any depreciation deduction. Thus the Commissioner corrected the taxpayer's error (which in reality was as much his as the taxpayer's) to the extent that the correction worked in favor of the Government, but refused to correct the error to the extent that the correction would have worked in favor of the taxpayer. The Commissioner contended, and both Courts below held, that the *Virginian Hotel* case established the inflexible rule that in every case where a depreciation deduction is entered on a tax return and not challenged it is "allowed" within the meaning of Section 113(b)(1)(B) of the Internal Revenue Code.

It seems patently absurd to say that in any substantial sense an erroneous depreciation figure is "allowed" by the

Commissioner and that consequently the taxpayer cannot restore to basis the erroneous deduction when, at the first occasion when it becomes of any importance, the Commissioner *disallows* the very basis upon which the depreciation is computed and when no benefit to the taxpayer or harm to the Government resulted from the prior error. Either the *Virginian Hotel* decision does not require any such result or if it does, this Court would clearly wish to re-examine the decision and lay down a rule which is not altogether out of keeping with reason and common sense.

Petitioner frankly concedes that this Court has denied certiorari in four cases which have raised the question of the correctness of the *Virginian Hotel* rule. *Commerce Co.* v. *United States,* 171 F. 2d 189, *cert. denied* 336 U. S. 972; *Bank of America* v. *United States,* 168 F. 2d 399, *cert denied,* 335 U. S. 827; *Repplier Coal Co.* v. *Commissioner,* 140 F. 2d 554, *cert. denied,* 323 U. S. 736; and *Piedmont Cotton Mills* v. *Commissioner,* 177 F. 2d 148, *cert. denied,* 339 U. S. 919. In all of those cases, however, the Government has merely contended that, having once been decided, the *Virginian Hotel* issue should not be reexamined. It has never met frankly the compelling arguments advanced by taxpayers in support of their contention that the *Virginian Hotel* decision should be overruled or limited. See for example the petition and response in *Piedmont Cotton Mills* v. *Commissioner, supra.* We submit that if the Government addressed itself to the merits of this controversy, it would be clearly apparent to the Court that it had promulgated an erroneous rule which should be corrected.

In those instances in which it has sought to justify or minimize the significance of the *Virginian Hotel* rule, the Government has addressed itself almost exclusively to cases where the depreciation figures entered on taxpayer's returns resulted from a determination of useful life of property which was correct in the light of the facts reasonably

known to exist at the time the determination was made and which turned out to be erroneous only in the light of later facts.[1] Such depreciation figures are "allowable"[2] and the question whether they have been "allowed" is immaterial. The Government has thus evaded the issue presented in a case such as the present where depreciation is erroneous in the light of facts existing at the time the depreciation deduction is entered on the return.

In the present case the taxpayer has been denied the right to correct an error, although, as the facts incontrovertibly reveal, it was a genuine error at the time it was made, and although it resulted in no damage to the Government or gain to the taxpayer. And this although the Government is actually profiting from the mistake, since it collected taxes for the years 1942-1944 to which it would not have been entitled if the error had not occurred, notwithstanding that the error caused no loss of taxes in the earlier years. Such a harsh rule has never been applied in any other instance in the field of income taxation from 1913 to date, and no reason has ever been suggested why Congress would have intended to apply such a rule here. The rule is attributable, we submit, to a misunderstanding on the part of this Court and on the part of counsel for the Government in the *Virginian Hotel* case, of the basic principles of tax administration, which have universally disregarded all errors in returns for prior years where there is no basis for estoppel and have not permitted harmless errors in prior years returns to distort income in a later year.

The rationale of the *Virginian Hotel* decision is that if deductions are not *"challenged"* by the Commissioner they are *"allowed"*. The Court below squarely bases its

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[1] See e.g., Brief for Commissioner, *Virginian Hotel Corporation* v. *Helvering*, pp. 9, 21-22.

[2] *Commissioner* v. *Mutual Fertilizer Co.*, 159 F. 2d 470 (C.A. 5th, 1947) (Citing relevant Treasury Regulations).

decision upon that sole premise.[3] That premise overlooks the fact that where the correction of an excessively high depreciation deduction would result in no increase in tax liability there is no procedure whereby the Commissioner can *challenge* the deduction. His only authority is to make corrections which are required for a correct determination of tax liability. Where a correction would not affect tax liability—and it is stipulated in this case that the use of correct depreciation figures would not have resulted in any taxable income for any of the years 1935-1941—the Commissioner has no reason or authority to make any correction. This the Government will freely admit. And it is clear, therefore, that since the Commissioner has no reason or authority to act, his failure to act can have no significance. This Court, however has attributed great significance to the Commissioner's failure to exercise an authority which he obviously does not have. A decision based upon a premise so obviously false could not fail to produce absurd results. Where, as in the case at bar, it leads to a holding that the correction of a harmless error in prior years' returns is permitted for one purpose and denied for another the result verges on the ridiculous.

In these times when taxes have recently been substantially increased and will certainly be raised to extremely high levels, it is of the utmost importance that their administration be rational and just. With a view toward the accomplishment of this significant end, we submit that the Court should grant this petition and overrule its decision in the *Virginian Hotel* case or explain the decision as having a much narrower application than is attributed to it by the Commissioner and by the Court below. By so doing it will violate no principle of *stare decisis;* it will

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[3] "If deductions are not challenged (by the Commissioner) they certainly are 'allowed' ", R. 43.

disturb no rights which have arisen in reliance on the *Virginian Hotel* rule; it will simply eliminate an erroneous and unfair rule of tax law for which no one has ever offered a single valid justification. The importance to the Government of the good will and respect of taxpayers is difficult to exaggerate. Nothing tends more to destroy taxpayer morale than to make taxes depend upon rules which are arbitrary and capricious.

Respectfully submitted,

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